receive 80 percent of the profits or losses; the corporate share would be the reverse. In computing profits or losses, each participant would first receive interest at the rate of 8 percent on his respective capital contribution. Although purchases and sales would be mutually agreed upon, the corporation could liquidate the joint portfolio if the individual's share of the losses equaled or exceeded his 20 percent contribution to the venture. The corporation would hold the securities, and upon termination of the venture, the assets would first be applied to repayment of capital contributions.

(c) In general, the relationship of joint venture is created when two or more persons combine their money, property, or time in the conduct of some particular line of trade or some particular business and agree to share jointly, or in proportion to capital contributed, the profits and losses of the undertaking.

(d) The incidents of the joint venture described above, however, closely parallel those of an extension of margin credit, with the corporation as lender and the individual as borrower. The corporation supplies 80 percent of the purchase price of securities in exchange for a net return of 8 percent of the amount advanced plus 20 percent of any gain. Like a lender of securities credit, the corporation is insulated against loss by retaining the right to liquidate the collateral before the securities decline in price below the amount of its contribution. Conversely, the individual—like a customer who borrows to purchase securities—puts up only 20 percent of their cost, is entitled to the principal portion of any appreciation in their value, bears the principal risk of loss should that value decline, and does not stand to gain or lose except through a change in value of the securities purchased.

(e) The Board is of the opinion that where the right of an individual to share in profits and losses of such a joint venture is disproportionate to his contribution to the venture:

(1) The joint venture involves an extension of credit by the corporation to the individual;

(2) The extension of credit is to purchase or carry registered equity securities, and is collateralized by such securities; and

(3) If the corporation is neither a bank subject to Regulation U nor a broker or dealer subject to Regulation T, the credit is of the kind described by § 207.1(a) of Regulation G.

[34 FR 9121, June 10, 1969]

§ 207.105 Applicability of plan-lender provisions to financing of stock options and stock purchase rights qualified or restricted under Internal Revenue Code.

(a) The Board has recently been asked whether the plan-lender provisions of § 207.4(a) of Regulation G, ''Securities Credit by Persons other than Banks, Brokers, or Dealers,'' were intended to apply to the financing of stock options restricted or qualified under the Internal Revenue Code where such options or the option plan do not provide for such financing.

(b) Section 207.4(a) of Regulation G permits a corporation or its plan-lender to extend credit to its employees without regard to the normal credit limitations of the regulation for the purpose of exercising stock options or stock purchase rights if the plan or agreement under which the credit is extended complies with certain requirements. Paragraph (1) of § 207.4(a) is in effect a ''grandfather clause,'' exempting from most of the credit limitations of Regulation G any such credit extended in connection with options or rights meeting certain specified ''preexisting'' conditions. Generally, these conditions recognize inequities that would result from application of the regulation's restrictions to credit extended in connection with options or rights granted, or contractual commitments made prior to February 1, 1968, the date the adoption of Regulation G was announced. Paragraph (2) of § 207.4(a) provides a more limited exemption for credit extended in connection with options or rights granted after February 1, 1968, and establishes requirements for plans seeking to qualify for this exemption.

(c) Paragraph (iii) of § 207.4(a)(1), which was added effective July 8, 1969, was designed to provide exemption, from all but certain reporting provisions, for credit extended pursuant to

the exercise of stock options or rights that are qualified or restricted under sections 422 through 424 of the Internal Revenue Code, if the options or rights were granted prior to February 1, 1968. This exemption applies only to those plans that provided for credit. This is because (1) employer-lenders who intended to supply credit when granting such options could not have anticipated the requirements of Regulation G and (2) the position of the Commissioner of Internal Revenue that such plans cannot be modified, would frustrate that intention. If a particular plan did not provide for credit, no expectations would be defeated by the fact that it could not be modified to add such provisions.

(d) The recent amendment to paragraph (2) of §207.4(a), which applies to stock purchase as well as option plans, was to clarify that to be treated as subject to the more limited exemption in that subparagraph, an otherwise appropriate credit arrangement need not be part of the plan. It is the Board's experience that in some nonqualified plans, particularly stock purchase plans, the credit arrangement is distinct from the plan. So long as the credit extended, and particularly, in the present context, the character of the plan-lender, conforms with the requirements of the regulation, the fact that option and credit are provided for in separate documents is immaterial. It should be emphasized that the Board does not express any view on the preferability of qualified as opposed to nonqualified options; its role is merely to prevent excessive credit in this area.

(e) The amendments promulgated on February 10, 1969, made one other change in §207.4(a). This was the addition of the provision that the plan-lender must be wholly owned as well as controlled by the issuer of the collateral (taking as a whole, corporate groups including subsidiaries and affiliates). This insertion was made to clarify the Board's intent that, to qualify for special treatment under that section, the lender must stand in a special employer-employee relationship with the borrower, and a special relationship of issuer with regard to the collateral. The fact that the Board, for convenience and practical reasons, permitted the employing corporation to act through a subsidiary or other entity should not be interpreted to mean the Board intended the lender to be other than an entity whose overriding interests were coextensive with the issuer. An independent corporation, with independent interests was never intended, regardless of form, to be at the base of exempt stock-plan lending.

[34 FR 18242, Nov. 14, 1969]

§ 207.106 "Deep in the money put and call options" as extensions of credit.

For text of the interpretation on this subject, see §220.122 of this subchapter.

[35 FR 3280, Feb. 21, 1970]

§ 207.107 Status after July 8, 1969, of credit extended prior to that date to purchase or carry mutual fund shares.

For the text of interpretation, see §221.119 of this subchapter.

[35 FR 6959, May 1, 1970]

§ 207.108 Applicability of margin requirements to credit in connection with insurance premium funding programs.

(a) The Board has been asked numerous questions regarding purpose credit in connection with insurance premium funding programs. The inquiries are included in a set of guidelines in the format of questions and answers which follow. A glossary of terms customarily used in connection with insurance premium funding credit activities is included in the guidelines. Under a typical insurance premium funding program, a borrower acquires mutual fund shares for cash, or takes fund shares which he already owns, and then uses the loan value (currently 40 percent as set by the Board) to buy insurance. Usually, a funding company (the issuer) will sell both the fund shares and the insurance through either independent broker/dealers or subsidiaries or affiliates of the issuer. A typical plan may run for 10 or 15 years with annual insurance premiums due. To illustrate, assuming an annual insurance premium of $300, the participant is required to put up mutual fund shares equivalent to 250 percent of the premium or $750 ($750×40 percent loan